# IN THE SUPREME COURT OF THE UNITED STATES

**October Term, 1940**

**No. 490**

INTERNATIONAL COMPANY OF ST. LOUIS, A CORPORATION,
*PETITIONER,*

VS.

E. R. SLOAN, RECEIVER OF THE FEDERAL RESERVE LIFE INSURANCE COMPANY, A CORPORATION, AND OCCIDENTAL LIFE INSURANCE COMPANY, A CORPORATION.

## BRIEF ON BEHALF OF E. R. SLOAN, RECEIVER OF THE FEDERAL RESERVE LIFE INSURANCE COMPANY IN RESISTANCE TO PETITION FOR WRIT OF CERTIORARI.

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## STATEMENT

As the essential facts appear in the opinion of the Circuit Court of Appeals, we will not set forth here any detailed statement. It appears to us that the lower court correctly interpreted the rights of the parties under the written instrument upon which the petitioner's claim is based.

The opinion of the lower court in its essence being merely an interpretation of a written instrument in the light of the facts and circumstances surrounding the parties at the time of its issuance, and the instrument being *sui generis,* we can discern in the record no reasonable basis upon which a writ of certiorari might be allowed.

The opinion of the Circuit Court of Appeals discusses and

passes upon three out of a number of grounds for affirming the district court's decision discussed in the briefs filed by appellees in that Court. We will in this brief discuss briefly the three grounds for affirmance decided by the Circuit Court of Appeals. All of them, in our opinion, were correctly decided. Certiorari should, of course, be denied, if the decision of the Circuit Court of Appeals is correct on any one of these grounds.

## BRIEF AND ARGUMENT

### I.

**Whether Its Status Be Described as Like That of a Preferred Stockholder or Otherwise, the Holder of the Participating Certificate Cannot Assert Its Claim in the Liquidating Receivership in Any Manner That Will Prevent the Realization by the Policyholders of the Full Value of the Defunct Corporation's Assets.**

It is the policyholders who are most seriously menaced by the assertion of this claim. They are the preferred creditors of The Federal Reserve Life Insurance Company and as such are entitled to have applied towards the partial payment of their claims the full value of the assets of the defunct corporation. If the International's claim be allowed, there will be appropriated to that claimant and taken away from the policyholders a very material portion of the value of the assets of the defunct corporation, which the Court intended should go to the policyholders.

At the time the Receiver was appointed the assets of The Federal Reserve Life Insurance Company were so impaired that their value was equal to only half of the net equities or the then value of policyholders claims. In transferring these assets to the Occidental through the Reinsurance Agreement, to purchase for the Federal Reserve policyholders insurance protection in the Occidental, the Court had included

a provision that the face amount of the Federal Reserve policies should be assumed and paid by the Occidental in case of death of a policyholder during a fifteen year period (R. 43), but that a policyholder could get only half of the net equity of his policy if he elected to cash surrender it or obtain a loan upon it. (R. 50.) In other words, as expressed in the Reinsurance Agreement, the net equities of the policyholders were subject to a fifty per cent lien. The Court, however, made provisions in the Reinsurance Agreement whereby earnings or profits from the Federal Reserve fund as they accrued were to be used in reduction of this lien. (R. 45-46.)

Paragraph 5 of the Stipulated Facts recites that the $300,000.00 paid in by the Insurance Investment Corporation, upon receipt of which the so-called "Participating Certificate" was issued, "*was placed in the surplus account of the Federal Reserve.*" (R. 75.)

You cannot build up a surplus by borrowing money. The two terms are contradictory; they are antonyms. The purpose of a call or demand for additional capital or of an addition to surplus is to have the new funds available for the payment of creditors in the event of liquidation.

To make it plain that the holder of the Participating Certificate was not to be a creditor of the Federal Reserve the Participating Certificate contained this recital (R. 75):

> "The obligation of the company hereunder *is a contingent liability, not an absolute promise to pay,* but is limited to its firm obligation and covenant to apply the said surplus gains to the making of the payments herein provided for, and *is not an obligation to be paid out of the general assets of the company* other than the fund mentioned in this certificate."

A stockholder who, to keep a shaky, tottering corporation on its feet, puts new money into the surplus funds of the com-

pany upon the express condition that it will never be returned to him unless the company is able to build up out of future earnings a specified surplus fund, has invested his money in the enterprise subject to the risks and hazards of the business. It seems perfectly obvious that he cannot, when insolvency arrives and forced liquidation becomes necessary, assume the role of a creditor. By whatever name he may be called, his status at best is no better than that of a preferred stockholder who can look only to whatever assets may be left after claims of the true creditors have been paid in full.

The allowance to this certificate holder of a lien upon future profits to be derived from the Federal Reserve assets would diminish the realization and application of the full value of the assets toward the payment of policyholders and other creditors practically to the same extent as though the lien were claimed upon the corpus of the assets instead of upon future profits.

The following quotation from the opinion of the court in *Re Hawkeye Oil Co.,* 19 Fed. (2d) 151 (D.C. Ill.), is peculiarly applicable to the present case:

> "The money to be paid by the company was not to be paid absolutely and at all events, but from a fund arising from the operation of the company. Whether the holders of such contracts are more analogous to stockholders (Fletcher, Cyclopedia Corporations, Par. 3631) than to sleeping partners is, I think, not of such vital importance as the underlying fact, upon which I am in accord with Judge Schoomaker and the referee, that they are not creditors, but are coadventurers with the stockholders, hazarding their investment upon the continued operation, and hence upon the success of the company. The rights of such persons are subordinate to those of general creditors."

*In Re Lathrop,* 61 Fed. (2d) 37 (9th C.C.A. 1932) cited in the opinion of the Circuit Court of Appeals in the pres-

ent case, an oil lease operator issued and sold certificates which provided that the holders should receive a specified percentage of the oil and gas produced from wells sunk on certain premises. Lathrop, who had issued the certificates was later adjudged a bankrupt; but the claims were disallowed. In the opinion the Court said:

> "So in the instant case. Whether or not the per cent holders come under the technical classification of stockholders, they are, . . . like stockholders, partners or joint adventurers . . . 'investors,' participants in the common enterprise. Had the bankrupt prospered and continued the operation of the oil well, these per cent holders would have prospered with him, to an extent that their certificates did not even attempt to limit. Conversely, these same holders must be prepared to share in the bankrupt's misfortunes. There is no equity in their favor that places them in a position equal to that of general creditors, who sold merchandise or labor at only a normal profit. The creditors should not be first to be sacrificed. It is the 'investors' who should be ready to take the bitter with the sweet."

## II.

**The Circuit Court of Appeals Correctly Ruled That the Provisions in the Participating Certificate That in the Event of a Reinsurance of the Business of the Federal Reserve the Reinsuring Company Shall be Bound to Pay the Savings and Profits to the Holder of the Certificate Did Not Apply to a Reinsurance Agreement Entered Into by the Receiver After the Federal Reserve Became Insolvent and Ceased to Carry on Its Business.**

The International's claim is based solely upon the following provision in the Participating Certificate, all the other terms and provisions of the Certificate being ignored:

> "In the event of a reinsurance of the business of The Federal Reserve Life Insurance Company the re-

> insuring company shall be bound each six months (6) to pay the savings and profits out of the reinsured business . . . to the then holder or holders of this Certificate." (R. 75.)

Whether the parties intended that this reference to "reinsurance" should apply not only to a voluntary reinsurance agreement that might be entered into while the Federal Reserve was solvent and in active business, but also to a Court's use of a reinsurance agreement as a medium for applying the assets to the use and benefit of the policyholders in the event the Federal Reserve should become insolvent, is a question to be determined upon a consideration not merely of this one paragraph in the Participating Certificate but upon a consideration of all the terms and provisions of the instrument. There must also be considered the facts and circumstances that led up to and attended the issuance of the Participating Certificate.

The recitals in the Participating Certificate to the effect that it shall be only a contingent obligation and not an absolute promise to pay and that it shall not be payable out of the general assets of the company show quite plainly that in the event of insolvency the assets of the company were to be disposed of for the benefit of policyholders and other creditors. These provisions clearly mean that freedom of the assets themselves from any liability to be applied towards paying the Participating Certificate included, when the Receiver should dispose of the assets, freedom also of their future income from any liability to be applied to that purpose. Freedom of the assets without freedom of their income, in the event of insolvency, would have been only a hollow pretense. A reading of the Participating Certificate in its entirety clearly shows a major underlying purpose of absolute freedom of the assets from liability on the Participating Certificate, whenever by reason of the condition of the Federal Reserve's affairs

it became necessary to apply its assets towards payment of claims. This major underlying purpose cannot, with any respect for logical reasoning, be held subject to reversal and defeat, if the Receiver's purchaser, instead of paying an all cash consideration for the insolvent's assets bought the assets upon a basis whereby the consideration therefor was a partial reinsurance of the Federal Reserve policyholders, together with an agreement to keep the assets intact and pay earnings or profits over a fifteen-year period.

It must follow that the language of the Certificate as a whole indicates an intention that whenever insolvency overtook the Federal Reserve, the Receiver might dispose of the assets in whatever way would realize the full value for the policyholders—whether by a sale for cash or through a reinsurance agreement. The provisions of the Participating Certificate itself, therefore, show that the reference to "reinsurance" was intended to apply only to voluntary reinsurance agreements that might be entered into by the Federal Reserve itself while it was solvent and in active business.

This conclusion is further supported by the reference in the Participating Certificate to "reinsurance *of the business of the Federal Reserve Life Insurance Company.*" When the company became insolvent and a Receiver was appointed the Federal Reserve ceased to engage in business. The Court enjoined it from doing business. Insolvency breached its insurance contracts. Policyholders became creditors. What the Receiver did was not to "reinsure the business of the Federal Reserve Life Insurance Company," but to use the assets of the defunct company—now the property of the former policyholders of the Federal Reserve—to buy partial reinsurance for them in the Occidental.

It may be sufficient here to call attention to the fact that an official examination of the Federal Reserve's finances had disclosed depleted capital and reserves; that a Committee of

Federal Reserve's directors called upon the Insurance Commissioner and the Attorney General to ascertain what action to better the situation would be required by these officials; that the State officials then assented to a proposal that certain stockholders put $300,000.00 of new money in the company's reserve account and that the company execute in return therefor a document in the form of this Participating Certificate. (See C.C.A. opinion, R. 187.)

Thus the surrounding facts and circumstances show that an involuntary insurance agreement of the Receiver in liquidating assets after the Federal Reserve became insolvent was not such "reinsurance" as is referred to in the Participating Certificate.

There is a close analogy between the reference in the Participating Certificate to "reinsurance" and the covenants in leases and other contracts forbidding assignment. In 16 R.C.L. 834 the rule is thus stated:

> "A general restriction on the right to assign is held to include only a voluntary assignment and not an involuntary assignment."

In a note in 46 A.L.R. 847 the author thus states the rule. citing many cases in support thereof:

> "The weight of authority (of recent cases at least) is that a general covenant against assignment of a lease without the lessor's consent is not violated by a transfer in bankruptcy or insolvency proceedings."

One of the leading cases is *Gazley v. Williams,* 210 U.S. 41, 28 Sup. Ct. 687, 22 L. ed. 950. In that case the second syllabus reads:

> "The passage of a lease from the bankrupt to the Trustee is by operation of law and not by the act of the bankrupt nor by sale, and a sale by the Trustee of the bankrupt's interest is not forbidden by, nor is it a

breach of, a covenant for reentry in case of assignment by the lessee or sale of his interest under execution or other legal process, where, as in this case, there is no covenant against transfer by operation of law."

It was clearly intended by all parties when the Participating Certificate was issued that, in the event of insolvency, the full value of the company's assets must be realized for the protection and benefit of the policyholders. The present claimant concedes that the full value could have been realized by a sale for cash, and that if the sale had been made for cash all right of the certificate holder to make claim against the assets themselves, or against the future income therefrom, would have terminated.

We submit that it is wholly illogical to contend that the Receiver had open to him the two methods of distributing the assets, both of them entirely legal and both intended for the protection of the policyholders, but that there was a difference of more than $300,000.00 (the principal of petitioner's claim) in the amount to be realized for the policyholders as between the two methods. The logical conclusion is that stated in the Circuit Court of Appeals' opinion, *i. e.,* that the reference in the Participating Certificate to "reinsurance" was to apply only to such a reinsurance agreement as the Federal Reserve might make while it remained solvent and in business.

## III.

**The Receiver's Sale in Consideration of a Contract to Reinsure the Policyholders Was the Legal Equivalent of Foreclosure.**

The Circuit Court of Appeals correctly ruled that the sale and transfer of the assets under order of the Court in the receivership proceeding was equivalent in law to a fore-

closure of the paramount lien or interest of the policyholders.

When the permanent Receiver was appointed, the Court gave consideration to the question of whether the lien of the policyholders upon the assets could be best protected (1) by the sale of the assets and payment of the proceeds of the sale *pro rata* to the policyholders, or (2) by having the receiver enter into a contract whereby each policyholder would be given an opportunity to have his *pro rata* share of the assets paid to him in cash or applied towards the purchase of new insurance. The second of these plans was found by the Court to be most beneficial to the policyholders. (R. 33-40.) The assets were accordingly transferred to the Occidental as the highest bidder, upon its agreement to pay to each policyholder who elected to take cash his share in the assets of the Federal Reserve, and that the balance of the assets would be used for the benefit of the other policyholders in the purchase of new insurance in the Occidental under the terms of the re-insurance agreement.

When the Federal Reserve policyholders had made their election to take the Occidental insurance or to draw down the cash after the bid of the Occidental had been accepted and after the reinsurance agreement was entered into, a "distribution of the insolvent's estate took place." The legal effect of the transaction was the same as though the Occidental had bid for and purchased the Federal Reserve assets for a sum equal to one-half of the computed value of the net equity of each policyholder and had paid this amount in cash to the receiver plus the net earnings. In view of the Court's order giving each policyholder the right to claim and receive his proportionate share in cash, the Receiver had in legal effect held the entire purchase price awaiting decision by each individual policyholder as to whether he would take down in money his share of the

cash consideration or would permit the Receiver, as his agent to expend it for him in purchasing new insurance protection in the Occidental, *including the right to participate in net earnings of the Federal Reserve Fund up to June* 13, 1951.)

It is true that most of the old Federal Reserve policyholders took this new insurance protection and that only a few of them actually drew down their cash. But each one of the old policyholders had the right to claim his share in cash, so that what was done by the Court through its Receiver was in legal effect a sale and distribution of the insolvent's assets. If every one of the old Federal Reserve policyholders had actually drawn down his share of the cash and had declined the proffered opportunity to have the Receiver reinvest it by purchasing the "new insurance protection" offered by the Occidental, it is clear that the Occidental would have had to pay each one in cash, and there would have been no reinsurance. We would then have had in fact, as we did have in legal effect, the usual liquidation process for an insolvent debtor—that is, a sale of the debtor's assets and a distribution of the proceeds of the sale in payment of dividends.

The disposition of assets of insolvent life insurance companies through reinsurance agreements of this same general character is commonly accepted as a proper and legal method of sale. It has the sanction of the courts.

Through such beneficent methods in handling receiverships of insolvent life insurance companies, the rights of all parties are adequately safeguarded and the life savings of the whole group of policyholders paid in for the protection of their families is saved from the disastrous results that would ensue if disintegration of the enterprise were effected through a complete liquidation.

In *Daniel v. Layton,* 75 Fed. (2d) 175, (7 C.C.A. 1935)

the Illinois Life Insurance Company was adjudged insolvent and a Receiver was appointed therefor. The Receiver, acting pursuant to the orders of the Court, transferred the assets of the defunct company to the Central Life Insurance Company in consideration of the transferee insuring the lives of the policyholders of the insolvent company. Certain non-policyholder creditors objected to the disposition which the Court made of the assets of the insolvent company on the ground that the Court did not sell the assets for cash. The Court held no complaint could be predicated on the objection made, saying:

> "Nor do we see merit in appellants' contention that they are entitled to have the property sold and the affairs of the company liquidated, even though they frustrate the plan of reinsurance and defeat the rights of the policyholders whose claims are perhaps fifty times as great as appellants'. The case of *Coriell v. Morris White Inc.,* (C.C.A.) 54 F. (2d) 255 is authority for the course pursued here. Even in the absence of precedent we think such a plan must meet with judicial approval. The contentions of one creditor must be considered in the light of their effect on other creditors. This, we think, is particularly true in insurance company reorganizations or where the insurance of an insolvent insurance company is reinsured in another company. All that any creditor may legitimately ask is fairness in the distribution of assets. In determining fairness the court may, in cases like the instant one, accept appraisal values instead of resorting to liquidation through sales, etc."

*Royal Union Life Insurance Company, v. Gross,* 76 Fed. (2d) 219 (8 C.C.A.) lays down the same rule, and in support thereof relies on *Phipps v. Chicago, R. I. & P. Ry. Co.,* 284 Fed. 925, and other cases cited by the Court.

A valid sale and distribution of the Federal Reserve assets having thus been made, the assets—not only the prin-

cipal thereof, but also the future savings and profits to be derived therefrom—have passed beyond the reach of this claimant whose contract by its own terms contemplated that he should not be a creditor and should have no claim upon the assets if the Federal Reserve went into forced liquidation.

## CONCLUSION

We respectfully submit that no adequate grounds are shown for issuance of a writ of certiorari and that the petition for the writ should be denied.

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